No. 11159

In the United States Circuit Court of Appeals for the Ninth Circuit

A. M. STANDISH, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

AND

BEATRICE M. STANDISH, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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CITATIONS

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 38–49) are reported at 4 T. C. 995.

JURISDICTION

The petitioners for review (R. 51–77) involve income taxes for the taxable years 1940 and 1941. On November 8, 1943, the Commissioner of Internal Revenue mailed to the taxpayers notices of deficiencies in the total amounts of $2,191.42 for the taxpayer A. M. Standish (R. 10–11) and $2,191.40 for the taxpayer

Beatrice M. Standish (R. 26–27). Within ninety days thereafter and on February 2, 1944, the taxpayers filed petitions in the Tax Court of the United States for redeterminations of those deficiencies under the provisions of Section 272 of the Internal Revenue Code. (R. 5–18, 21–34.) The case is brought to this Court by petitions for review filed on September 17, 1945. (R. 51–77.)

QUESTIONS PRESENTED

1. Whether the Tax Court erred in holding that the property in question was held in trust so that the taxpayers were not entitled to deduct from their individual incomes under Section 23 (e) (1) and (2) of the Internal Revenue Code a loss incurred with respect to the trust property.

2. Whether, if the Tax Court erred in holding that the property was held in trust, the case must be remanded for further proceedings.

STATUTES INVOLVED

Internal Revenue Code:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
>
> (1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1940 ed., Sec. 181.)

STATEMENT

The Tax Court found the facts as follows (R. 38–44):

The taxpayers, A. M. Standish and his wife, reside in Milpitas, California. They filed their income tax returns for the years 1940 and 1941 with the Collector of Internal Revenue for the First District of California. (R. 38.)

The taxpayers are partners in the ownership and operation of the property giving rise to the deductions claimed. The partnership was chiefly engaged in the operation of orchards. (R. 38.)

Miles Standish, the father of A. M. Standish, died on June 22, 1932, a resident of California. At the time of his death he was the owner in fee simple of an undivided one-half interest in certain real property in Coos County and Douglas County, Oregon, having a value of $19,462.25 for his half interest, as finally determined by the Commssioner in estate tax proceedings. The decedent's interest in the Douglas County lands was valued at $9,201 and in the Coos County

lands at $10,261.25. The Coos County holdings and their respective values were 520 acres of agricultural land, $14,560; 400 acres of timber land, $440; 1,000 acres of cut-over lands suitable for reforestation, $1,000; and 9,045 M feet of Douglas fir timber, $4,522.50, or a total of $20,522.50, the decedent's one-half being $10,261.25. The Douglas County property was all timber land. (R. 39.)

In 1941 all the Douglas County land was sold for the nonpayment of taxes and the tracts of the Coos County land suitable for agriculture and the timber land were also sold at tax sales, leaving unsold only the reforestation land. Prior to the tax sale, A. M. Standish and Henry B. Hickey, the owner of the other undivided one-half interest, had sold lands and timber therefrom for $3,521.95. (R. 39.)

The loss to the Standish interests were $17,201.28, composed of loss on the Douglas County tax sale ($9,201) and loss on the Coos County lands ($8,-000.28), computed by subtracting one-half of the value of the reforestation land unsold ($500) and one-half of the amount realized from the sale of timber and lands ($1,760.97) from the original value of the decedent's one-half interest ($10,261.25). (R. 39–40.)

On June 17, 1932, Miles Standish executed a deed of trust whose corpus included the Coos County and Douglas County lands. The trust directed that the corpus should be held by the trustees, who were to pay the net income therefrom to the grantor during his lifetime, and upon his death, to A. M. Standish, his wife and two children in designated proportions. The

trust instrument contained the following pertinent provisions (R. 40–41):

> This division of the net proceeds and income from the said property shall continue until the youngest grandchild shall have attained the age of thirty (30) years, when the Trustees shall convey to the Beneficiaries then living, all of the property then remaining in this trust, in such proportion as their respective interests are indicated by the percentages upon which the income has been paid to them, and the trust shall cease.
>
> * * * * *
>
> Eighth: In the event that I have any additional grandchild or grandchildren living at the time of my death, the shares of Patricia and Beatrice Standish shall be proportionately reduced so that such additional grandchild or grandchildren shall share equally with them.
>
> Ninth: In the event that any grandchild shall die prior to the time that the respective beneficial interest due said grandchild shall become payable in whole or part as herein provided, then the invested beneficial interest due said grandchild shall revert as follows:
>
> 1. If said deceased grandchild shall leave lawful heir of his or her body then such legal heir or heirs shall become the beneficiary in the place and stead of his or her parent by right of representation.
>
> 2. In the event any deceased grandchild leaves no legal heirs, then the beneficial interest to which said grandchild would otherwise be entitled shall revert to the equal benefit of the surviving grandchildren, the legal issue of any

> deceased grandchild to take by representation.
>
> 3. In the event that all of said grandchildren die without legal issue prior to the vesting of all of said trust estate, so much as remains shall be paid or delivered to any heirs of the first party under the law of succession as the same exists at the date of this instrument.

In 1941 a fiduciary return was filed for the Miles Standish Trust in which a loss of $14,943.60 was reported from the sale of the Coos County and Douglas County lands. (R. 41.)

Miles Standish left a will dated January 7, 1930, which established a testamentary trust. The will made specific bequests and then contained the following paragraph (R. 41-42):

> Fourth: I give, devise and bequeath to my said son, Allan M. Standish, all of the residue of my property and estate of every kind and nature, and wherever situate, of which I may die seized or possessed or in which I may have an interest, in trust, nevertheless, for the following uses and purposes, that is to say: To have, hold, manage and control, bargain, sell, transfer, exchange, invest and reinvest the proceeds thereof; to collect the income therefrom, and out of said income pay over one-half thereof to the Trustees of a certain Trust created by agreement in writing, dated the 7th day of January, 1930, made and executed by Miles Standish, the party of the first part therein named, and Miles Standish and Allan M. Standish, his son, the parties of the second part therein named, their successors and survivors, which said trust agreement is hereby

> referred to and made a part hereof, in trust, nevertheless, for the use and benefit of my grandchildren, Patricia Standish, and Beatrice Standish, the children of my said son, Allan M. Standish, and for the use and benefit of any other child or children hereafter born to my said son Allan M. Standish, in equal shares, as provided by the terms of said last named Trust, and to pay over the remaining one-half of said income to my said son Allan M. Standish, in his own right and for his own use and benefit; and as fast as said property is sold and the proceeds thereof collected, pay over and distribute the same in the manner and in the same proportions as said income is to be paid over and distributed; * * * in any event, this Trust shall terminate and division of the property shall be made as aforesaid, not later than fifteen (15) years from the date of my death.

The will was not probated in Oregon. No administrator of the decendent's estate was appointed in that State. The decedent had no debts in Oregon. The will was probated in California on June 29, 1932. The estate was not distributed until July 24, 1942. In the decree ordering the final distribution thereof, the Superior Court of the State of California for Santa Clara County decreed that A. M. Standish was entitled to one-half of the corpus of the specified property of the estate for his own use and benefit, and the other one-half should go to him in trust for the benefit of his two children, Patricia Standish and Beatrice Standish, at that time adult persons. (R. 42–43.)

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The Commissioner determined (R. 44) that—

> the loss of $10,512.92 claimed as sustained by the Miles Standish Trust upon the loss of certain timber property because of failure to pay taxes owing to the State of Oregon is disallowed on the ground that any loss sustained is deductible by the Estate of Miles Standish, Deceased, or trusts created by him, either prior to death or in his will.

The Tax Court found that the trust instrument did not violate the rules against perpetu~~ation~~ities, and that the taxpayers accordingly were entitled to no deduction with respect to a loss on the trust property.

SUMMARY OF ARGUMENT

The taxpayers dispute the disallowance of a claimed deduction from their individual incomes for a loss with respect to Oregon land, on the ground that although the land had been conveyed in trust, the conveyance was ineffective because it violated the rule against perpetuities.

All their arguments with respect to the validity of the trust rest upon the assumption that the period of perpetuities must be computed from the date of the execution of the trust, rather than from the date of the grantor's death. That assumption is erroneous, since the grantor retained the power at any time to revoke the trust and revest title in himself. Accordingly, under well-settled authority, the period is to be computed from the date of his death. If it is so computed, the trust was unquestionably valid, since all the interests created thereby must have vested by

the time of the death of persons living at the time of the grantor's death.

The taxpayers could not prevail even if it were held that the period of the rule must be computed from the date of the execution of the trust instrument. Their interests vested immediately, and accordingly did not violate the rule. If it be assumed that divesting interests in unborn persons violated the rule, there would still be no ground for holding that the trust was invalid as to the taxpayers. Such holding would have to rest upon an affirmative manifestation of the grantor's intention to that effect. There is no such manifestation; and on the contrary, it appears that to hold that the trust was wholly invalid would violate the grantor's intention.

If the Tax Court should be reversed on the question of the validity of the trust, the case should be remanded to it for further proceedings with regard to questions which it found unnecessary to decide.

ARGUMENT

I

The Tax Court did not err in holding that the property in question was held in trust, so that the taxpayers were not entitled to deduct from their individual incomes under Section 23 (e) (1) and (2) of the Internal Revenue Code a loss incurred with respect to the trust property

In returning their individual incomes for the tax period,[1] the taxpayers each deducted half the amount

[1] While the taxpayers were partners, Section 181 of the Internal Revenue Code, *supra*, provides that they shall be liable for income tax only in their individual capacities.

of losses allegedly sustained on certain Oregon land. The Commissioner determined, and the Tax Court held, that the land was held on trust, so that any loss was deductible only by the trustee from trust income; not by the taxpayers from their individual incomes under Section 23 (e) (1) and (2) of the Internal Revenue Code, *supra*. The taxpayers contend that although the land had been conveyed on trust the conveyance was ineffective, and title to the property remained in the grantor and eventually passed to them free of trust.

As the Tax Court observed (R. 46), the present case apparently is the first instance where the validity of the trust has been called in question; and the trust has apparently been given effect during the whole time since the trust instrument was executed in 1932. The taxpayers were themselves trustees, and the taxpayer A. M. Standish testified in the Tax Court that distributions have been made on the assumption that the trust was valid. (R. 90.) Indeed, he filed a federal income tax return for the trust for the year 1941 in which he deducted from trust income the very loss now sought to be deducted from the taxpayers' individual incomes. (R. 89.) We submit that the present attack upon the trust is as unfounded as it is untimely.

The taxpayers attack the trust solely under the rule against perpetuities. The short answer to all their arguments on this point is that they rest on the erroneous assumption that the period of perpetuities is to be computed from the date of execution of the trust instrument, rather than from the date of the grantor's

death. The error of that assumption is plain when it is considered that the grantor retained absolute power to revoke the trust at any time during his life. (R. 92.) Thus, until the time of the grantor's death, he had power in himself at any time to make himself the sole owner, and the time until his death must be excluded in computing the period of the rule. *Mifflin's Appeal,* 121 Pa. 205, 15 Atl. 525; *Manufacturers Life Ins. Co.* v. *Von Hamm-Young Co.,* 34 Hawaii 288; *Schenectady Trust Co.* v. *Emmons,* 261 App. Div. 154, 25 N. Y. S. 2d 230, affirmed, 286 N. Y. 626, 36 N. E. 2d 461; *Equitable Trust Co.* v. *Pratt,* 117 Misc. 708, 193 N. Y. S. 152, affirmed, 206 App. Div. 689, 199 N. Y. S. 921; *Bankers Trust Co.* v. *Topping,* 180 Misc. 596, 41 N. Y. S. 2d 736; Restatement, Property, Division IV (1944), § 373; Gray, Rule Against Perpetuities (4th ed.), §§ 203, 524.1; 2 Simes, Future Interests (1936), §§ 515–518; 5 Thompson on Real Property (Perm. Ed.), § 2723; 1 Tiffany, Real Property (2d ed.), §§ 183, 184; Leach, Perpetuities, 51 Harv. L. Rev. 638, 663 (1938); Note, 45 Harv. L. Rev. 896 (1932); cf. *Reinecke* v. *Northern Trust Co.,* 278 U. S. 339. While the law of Oregon, the state where the land in question lay (R. 39), appears to contain no explicit statement on the matter, there is no reason to doubt that this view obtains there. Cf. *Pearce* v. *Commissioner,* 315 U. S. 543.

With the period of the rule computed from the date of the grantor's death, the trust was unquestionably valid, since all interests therein must have vested by the time of the death of the taxpayers and grandchil-

dren of the grantor living at his death. (R. 93–96.) Cf. *Buchanan* v. *Schulderman,* 11 Ore. 150, 1 Pac. 899; *In re McGinnis' Estate,* 91 Ore. 407, 179 Pac. 254; *In re Will of Pittock,* 102 Ore. 159, 199 Pac. 633; *Gratton* v. *Gratton's Estate,* 133 Ore. 65, 283 Pac. 747.

The taxpayers could not prevail even if it were held that the period of the rule must be computed from the date of the execution of the trust instrument. As the Tax Court held (R. 47), the trust instrument created vested interests in the taxpayers and their two children, Patricia and Beatrice. It provided that 51% of the trust income be paid after the grantor's death to his son, the taxpayer A. M. Standish; 17% to the son's wife, the taxpayer Beatrice M. Standish; and 16% to each of Patricia and Beatrice, their children and the grantor's grandchildren. (R. 93.) Immediately following was a provision that this division of income should continue until the youngest grandchild reached the age of thirty, whereupon the trustees were to convey the trust property to the beneficiaries then living in proportion to the gifts of income. (R. 93.) There was a further provision (R. 95) that if the grantor should have any additional grandchild or grandchildren living at his death, "the shares of Patricia and Beatrice shall be proportionately reduced" so that all grandchildren should share equally. It was also provided that if any grandchild should die before "the respective beneficial interest due said grandchild shall become payable * * * then the invested beneficial interest due said grandchild shall revert" in a specified manner. (R. 95.)

The plain intention of this instrument was to give presently vested interests in the trust property to the two taxpayers and to their two named children, Beatrice and Patricia. As the Tax Court held, this construction is strongly favored by the intermediate gifts of income to them. See also 2 Simes, supra, § 356; 1 Tiffany, supra, § 168. The grantor elsewhere affirmatively indicated that the interests were vested when he provided that if other grandchildren be born before his death, "the shares of Patricia and Beatrice shall be proportionately reduced"; and that if any grandchild should die, his interest should "revert." (R. 95.) Cf. *Buchanan* v. *Schulderman,* supra.

Since the interests of the taxpayers and of their two named children were vested, there is no basis for contending that they violated the rule against perpetuities.

The taxpayers contend, however, that these interests must be struck down because under the terms of the instrument, grandchildren not in being at the time of execution of the instrument, but born before the grantor's death, might share in the distribution of the trust property.

The interests of those unborn grandchildren could operate only to divest the already vested interests of Patricia and Beatrice. As we have explained, even those divesting interests do not violate the rule against perpetuities, since the period is to be computed from the date of the grantor's death. But if it be assumed that the period is to be computed from the date of execution of the instrument, and that the di-

vesting interests do violate the rule against perpetuities, the case would still be no different. Although a deed contains provisions which are invalid under the rule against perpetuities, other provisions in the deed take effect as if the void provisions had not been employed, unless the grantor has affirmatively manifested an intention that they should not do so. Restatement of Property, *supra,* § 402; 2 Simes, *supra,* § 529; Gray, *supra,* § 247. There is no manifestation of such an intention here; on the contrary, there are affirmative indications that the grantor would not have intended that possible invalidity of the interests given unborn grandchildren would void the interests of the taxpayers and their two children named in the trust instrument. On the face of the instrument it appears that the grantor's primary concern was the welfare of the named beneficiaries; the gifts to those grandchildren who might be born between the time of execution of the trust instrument and the time of his death cannot be regarded as more than a conveyancer's flourish, especially when there is considered the fact that the trust instrument was executed only five days before the grantor's death. (R. 39, 40.)

II

If the Tax Court erred in holding that the property was subject to a valid trust, the case must be remanded for further proceedings

In view of its decision that the taxpayers could not in any event be entitled to the claimed loss because any loss would be deductible only by the trustee

from trust income, it was unnecessary for the Tax Court to pass upon numerous questions which would remain if it were decided that the trust was void. Thus, the Tax Court did not decide the question whether the property in question was subjected to a trust by the will of the grantor;[2] whether, if the loss was incurred by the taxpayers as individuals, it was incurred in a trade or business or in a transaction entered into for profit within the meaning of Section 23 (e) (1) and (2) of the Internal Revenue Code; whether if there was a deductible loss, it was subject to the limitations imposed upon capital losses by Section 117 (c) (d) of the Internal Revenue Code, as amended by Section 212 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862; whether part or all of the claimed loss should be disallowed on the ground that the taxpayers have not shown that it should not be attributed to the earlier years in which the state taxes which caused the "loss" were incurred; or whether, in view of the prior deduction of the loss in question from the trust income (R. 89), the case calls for remedial action under Section 3801 of the Internal Revenue Code. Finally, the taxpayers concede error in the Tax Court's finding of the amount of the "loss". (Br. 26–27.) These matters would call for further proceedings in the Tax Court before the case would be ready for final decision by this Court

[2] The taxpayers concede, as indeed they must, that the probate decree of the California court (R. 109–117) had no effect upon title to the Oregon land here in question (Br. 24–25). The will was not probated in Oregon, and no administrator was appointed there. (R. 42–43.)

(cf. *Helvering* v. *Rankin,* 295 U. S. 123) ; accordingly, we will not undertake to discuss them in this brief.

CONCLUSION

The decision of the court below is correct and should be affirmed.

Respectfully submitted,

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